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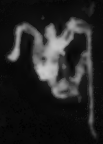

CIS Congressional Information Service
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Joint Committee on Taxation
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Penalties Relating to Foreign Tax Provisions

Present Law

Withholding

Persons having control, receipt, custody, disposal, or payment of certain types of U.S. income of foreign persons are required to deduct and withhold U.S. tax from such income under chapter 3 of the Code's income tax provisions (secs. 1441-1464). The amount withheld is credited against the U.S. tax liability of the foreign income recipient.

Where a tax on the U.S. income of a foreign recipient was required to be withheld but the withholding agent failed to do so, and instead the tax is paid by the income recipient, a penalty may be imposed on the recipient or the withholding agent for failure to pay the tax only if the failure was fraudulent and for the purpose of evading payment (sec. 1463). By contrast, where an employer fails to withhold income tax from an employee's wages but the employee pays the tax due, the employer remains liable for any penalties and additions to tax otherwise applicable (sec. 3402(d)).

Generally, any person required to serve as a withholding agent under chapter 3 must provide each income recipient an annual withholding statement (Form 1042S) and must file all required Forms 1042S with the IRS accompanied by a return (Form 1042) summarizing the information on the Forms 1042S (Reg. sec. 1.1461-2). Generally, the Code provides penalties for each failure to file a required information return with the IRS and each failure to provide a required payee statement (sec. 6721-6724). These penalties do not apply, however, to each failure with respect to Forms 1042S.

Information reporting

Generally, every U.S. person is required to report certain information concerning any foreign corporation that such person controls and information relating to transactions between the corporation and certain specified persons. Failure to provide such information subjects the U.S. person to a monetary penalty plus a denial of foreign tax credits (sec. 6038). These information reporting requirements and this penalty do not specifically refer to all types of information needed to determine tax liabilities with respect to controlled foreign corporations.

J862-36

Explanation of Provisions

Penalties for failure to withhold

The bill provides that in cases where a tax on the U.S. income of a foreign person was required to be withheld under chapter 3 but was not in fact withheld, and the income recipient instead satisfies its own proper tax liability, the withholding agent remains liable for any penalties and additions to tax otherwise applicable for failure to withhold. Thus, under the bill these withholding agents are subject to the same general approach applicable to U.S. employers who withhold income taxes from employees' wages.

Penalties for failure to file withholding statements

The bill integrates the penalty for failure to file Form 1042S and failure to provide Form 1042S to the payee into the general penalty structure. Thus, the bill treats each Form 1042S required to be filed with the IRS and provided to a payee as an information return and as a payee statement as those terms are defined in section 6724. Accordingly, each failure to file any required Form 1042S will be subject to a separate penalty under section 6721, and each failure to provide a payee any required Form 1042S will be subject to a separate penalty under section 6722.

Penalties for failure to report information with respect to certain foreign corporations

The bill clarifies the reporting requirements and penalties imposed by section 6038 by expressly applying those provisions to failures to provide certain information with respect to related parties, such as controlled foreign corporations of which the person subject to the requirements is a U.S. shareholder.